

EXECUTIVE CHAMBERS  
State Capitol  
Honolulu, Hawaii 96813

**GOVERNOR'S MESSAGE TO THE 24TH STATE  
LEGISLATURE OF HAWAII MEETING IN THE REGULAR  
SESSION OF 2008**

Pursuant to Article VII, Section 9 of the Hawaii Constitution, I hereby submit to the State Legislature the Executive Supplemental Budget for Fiscal Biennium 2007-09 and the updated Program and Financial Plan for the period 2007-13.

Within the framework of the State of Hawaii's biennial budget system, the General Appropriations Act of 2007 (Act 213, SLH 2007) is the primary plan that identifies the financial requirements of State agencies and programs and authorizes funding for the two-year fiscal period that begins on July 1, 2007 and ends on June 30, 2009. This Executive Supplemental Budget proposes only a limited number of changes and adjustments to Act 213, SLH 2007, that are deemed necessary at this time.

The overall economic context indicates a moderation in economic activity across the State, particularly in visitor arrivals and the construction industry. We have known that the past three years' extraordinary rates of economic growth could not be sustained over the long-term. The natural workings of the business cycle in an island economy created workforce shortages, resource constraints and inflationary pressures.

National and international trends, including moderation of growth rates of the U.S. economy and in Japan--the State's largest foreign market--coupled with the credit markets' fall-out due to the subprime mortgage crisis, have affected the amount of disposable income and confidence levels of Mainland visitors. Locally, these same factors have caused a slowdown in the purchases of housing and durable goods.

Reflecting real changes in the economy, state tax collections have shown a similar trend, growing at a slower rate as compared to the recent past. This overall economic context requires that we take a cautious and prudent approach to the State's financial situation.

The Executive Supplemental Budget that I am sending you reflects such an approach.

Staying within the intent of a supplemental budget, our instructions to all Executive Branch departments and agencies encompassed the following guidelines:

- Program goals should be accomplished within existing funding levels.
- Supplemental budget requests are limited to the most immediate and critical needs.
- Trade-offs and transfers among programs are encouraged to meet departmental needs and to bring about greater efficiency.

For FY 09, I am proposing an adjusted operating budget of \$10.8 billion from all means of financing. This represents an increase of \$306.7 million (or 2.9 %) over the current appropriation level. Of this total, the portion from general funds is \$5.4 billion, an increase of \$100.2 million (or 1.9 %) over the current appropriation level approved in Act 213, SLH 2007.

For capital improvements (CIP), I am recommending an additional \$1.1 billion for FY 09, bringing the total to \$1.6 billion from all means of financing. Close to half of the additional amount is from revenue bonds, a substantial portion of which is to finance our accelerated efforts to modernize State harbors and airports. The additional request for general obligation (G.O.) bonds is \$560.9 million, resulting in a total G.O. bond level of \$692.2 million for FY 09, including reimbursable issues.

Working within these new financial constraints, I believe we have succeeded in presenting to you a prudent budget with a clear focus on meeting Hawaii's critical needs at this time. We will continue to exercise fiscal restraint and take appropriate steps to ensure that the budget remains on a sustainable path.

## THE ECONOMY

As mentioned above, after three years of extraordinary growth from 2003 to 2006, Hawaii's economy continued to expand in 2007 but the pace of growth has moderated in recent months. For 2008 and the near term, we expect to see continued positive growth at a lower rate. The consensus view of economists is that our economy remains solid.

Hawaii's unemployment rate consistently stayed below 3% during the past three years and remained among the lowest in the nation. The number of new jobs being created grew at an average rate of 2.1% during 2007. Hawaii's total personal income increased by 6.7% in the first half of 2007 and is projected to grow by 6.2% by the end of the year and by 5.9% in 2008. These are all positive numbers that are consistent with the characteristics of a solid economy.

With the expected moderation of the economy, inflation, as measured by the Honolulu Consumer Price Index, dropped a full percentage point to stand at 4.9% in the first half of 2007.

## REVENUE PROJECTIONS

As expected, the moderation in the economy has had an impact on recent State tax collections. General fund tax revenues rose by 3.4% in FY 07, a significant difference from the double-digit growth of 16.0% in FY 05 and 10.9% in FY 06. In the first five months of FY 08, general fund tax revenues registered a preliminary 3.4% growth over the same period last year.

At its August 28, 2007 meeting, the Council on Revenues (COR) estimated that general fund tax revenues would grow by 5.7% in FY 08 and by 3.8% in FY 09. Revenue growth for the four out-years (FYs 10 to 13) is forecast to be in the range of 4.7% to 6.2%. These projections indicate that moderation in economic activities and tax revenues is expected to continue for the current fiscal biennium and into the four out-years of the planning horizon.

Besides current revenue sources, carry-over savings in the General Fund provide another means of funding that supports our budgetary needs. With a healthy economy and prudent management of State resources, we were successful in building a substantial balance in the General Fund that reached \$732.3 million in FY 06, the highest level ever achieved in Hawaii. These additional resources allowed the State to catch up with many critical needs that had been deferred in previous years.

However, beginning with FY 07, substantial increases in collective bargaining, specific appropriations, and grants to organizations began to reduce significantly the \$732.3 million balance in the General Fund. Specifically for FYs 07, 08 and 09, collective bargaining costs amount to \$523 million and appropriation measures outside the biennium budget add up to \$200 million. Cash CIPs in the sum of \$169 million also impacted the carry-over amount. As a result, with only moderate growth expected in tax revenues, the general fund balance is projected to decrease to \$475.4 million at the end of FY 08 and to further decrease to \$213 million at the end of FY 09.

## THE PROGRAM AGENDA

Funding recommendations included in the Executive Supplemental Budget for FY 2007-09 are being proposed to address the requirements that I will discuss below.

### Increases in Employees' Fringe Benefit Costs

Act 256, SLH 2007, mandates an increase in the rate of contribution by the employer to the Employees Retirement System for pension accumulation to address the unfunded liability condition in the retirement system. However, the Legislature failed to include funding for this requirement in the General Appropriations Act. As a result, the additional cost included in the supplemental budget is \$57.7 million for FY 09, and this obligation will continue in the out-years.

Contributions for Social Security and Medicare benefits are also projected to increase by \$8.4 million in FY 09 based on more recent and actual payroll data.

These increases serve as a reminder that payroll and fringe benefits are a major cost, accounting for a significant share of the total budget. They must be closely managed for the budget to be sustainable.

### Education

The General Appropriations Act of 2007 and various specific appropriation acts have already authorized substantial funding for education. The proposed supplemental operating budget includes additional funding for recent developments such as the conversion of Kamaile Elementary School to a public charter school, provision for three new charter schools, and the plan for establishing 108 positions in the Department of Education (DOE) for in-house autism services instead of contracted providers.

The CIP program continues to concentrate on improving and renovating existing facilities while also planning for new schools to meet the needs of expanding communities. A total of \$40 million in G.O. bonds is requested for renovations at McKinley High School and Konawaena Middle School, for additional classrooms at Kaunakakai Elementary School and Lanai High and Elementary School, for a new library at Kapaa Elementary School, for design of a new elementary school in Kapolei, and for school building improvements statewide.

Substantial funding for school repairs and renovations has been authorized in recent years. Act 246, SLH 2006, provided \$160 million in general funds for classroom renovations and Act 213, SLH 2007, appropriated an additional \$50 million, also in general funds, for school repairs and maintenance, for a total of \$210 million to be expended during the current biennium. Paying cash for capital improvements may have been a reasonable option when revenues were abundant, but it is not a prudent approach at this time. Therefore, with this supplemental budget, we are changing the means of financing from general funds to G.O. bonds for \$140 million of these DOE authorizations. This conversion will allow the projects to be implemented while general funds are reserved for pressing operational needs.

### University of Hawaii

Operating funds are requested to address security issues on all campuses. A total of \$4.4 million is proposed to add additional security personnel and support staff, enhance emergency communication and surveillance systems, and provide necessary equipment and vehicles. Another \$2.5 million is recommended for improvement of library collections and services at the Manoa campus. For capital improvements, a total of \$100.6 million will be needed. Included in this amount is funding for the Hawaiian Language Building at the Hilo campus (\$19.9 million) and \$50 million for the University to meet health and safety requirements as well as major maintenance needs throughout the system.

### Affordable Housing

Efforts to keep the Kukui Gardens Rental Housing Complex affordable have been successful. Following through with the State's commitment to preserving affordable rental properties in urban Honolulu, we are requesting \$26 million in taxable G.O. bonds in this supplemental budget to complete the acquisition of land and construction of improvements on Parcel A of the complex.

On another front, the Hawaii Housing Finance and Development Corporation (HHFDC) has been active in pursuing the goal of increasing the stock of affordable rental housing in the State. To support HHFDC in its mission, we are proposing an infusion of \$25 million in taxable G.O. bonds into the Rental Housing Trust Fund to provide equity gap financing to developers of affordable rental housing projects. Another infusion of \$25 million in taxable G.O. bonds is recommended for the Dwelling Unit Revolving Fund to provide interim financing for affordable housing development.

The need for major repairs and renovations throughout our public housing projects is critical and immediate because the Legislature provided funding for only one year of the current biennium budget. We are requesting an additional \$6.4 million in G.O. bonds for the completion of elevator repairs at various housing projects and another \$20 million for major repairs of public housing properties statewide.

### Assistance for the Homeless

Our initiatives to provide temporary shelter and support services to our less fortunate residents who are homeless have produced good results. There are now four operational centers in Waianae, Kalaeloa, and Lihue as well as the Next Step shelter downtown. Other shelters that are currently under development at Maili and Kalaeloa and on Kauai and the Big Island will be operational by June 30, 2008, ahead of schedule. To allow for immediate occupancy and operations, we are requesting an additional \$4.3 million to provide operating funds for the service contracts

that will be required. The challenges in providing appropriate shelter for the homeless population are long standing and will require our continued commitment. With the expected closing of the Next Step shelter in Kakaako in 2008, we are pursuing the development of a permanent facility for the homeless population in urban Honolulu. A request of \$20 million in G.O. bonds is proposed for this purpose.

### Hawaiian Home Lands

It is imperative that we fulfill our commitment to native Hawaiians and actively pursue plans for putting people on the land. There is a clear need to develop infrastructure and homes for new homestead areas across the State. We are thus proposing \$100 million in revenue bonds for development of Hawaiian home lands statewide to support the goal of delivering approximately 1,000 home sites to beneficiaries throughout the islands.

### Healthcare

The Adult Mental Health program is an area where we continue to see an increase in demand for services due to a growing population, court orders and new treatment strategies. The supplemental budget includes an additional \$10 million in operating funds for outpatient services with contract providers. As more patients are channeled toward community based programs, the Hawaii State Hospital will be able to accept a growing number of court ordered cases.

For the Hawaii Health System Corporation (HHSC), a total of \$11.3 million in G.O. bonds is recommended for critical repairs at specific community hospitals on all major islands. However, no additional operating funds are proposed at this time. Act 290, SLH 2007, changed the governance of HHSC by transitioning it into a regional board system. The supplemental operating request was, therefore, deferred to allow the newer members an

opportunity to evaluate the complex financial situation of their respective regions and to develop their budgetary requirements accordingly.

Subsidies to Kahuku Hospital have not been included in the supplemental budget because it is not yet a part of HHSC. Therefore, Kahuku Hospital's request must be submitted directly to the Legislature.

### Transportation

A major initiative in this supplemental budget is the push for modernization of the Hawaii harbor system to meet new, expanded demands and enhanced security standards. The Harbor Modernization Plan, developed with input and support from the industry users group, identifies the tasks that must be done to increase capacity at Honolulu Harbor, provide capacity for future inter-island cargo movements, improve Kahului Harbor, and develop energy infrastructure. A total of \$124.4 million in revenue bonds is being proposed to begin implementing the first phase of the plan that includes Honolulu, Kalaheo Barbers Point, Kahului, Hilo, Kawaihae and Nawiliwili Harbors.

CIP requests for the State's airport system amount to \$250.1 million in revenue bonds and reflect the continued efforts toward modernization. The requested amounts provide funding for major improvements at Honolulu International and Kahului Airports, including new and expanded parking facilities, improvements to the baggage handling system at Lihue Airport, noise attenuation at Hilo Airport, and security enhancements at all major airports.

The Highways program faces considerable financial difficulties. The Highway Special Fund currently does not have sufficient revenues to support all projected costs. To address the need for additional revenues, we will propose legislation to continue the \$3 surcharge on rental vehicles that was authorized in Act 223, SLH 1999, to provide an estimated \$14 million a year for the

Highway Special Fund. Also, an emergency appropriation request of \$20 million in special funds will be submitted this session to meet increases in operating costs, including special maintenance. For FY 09, the supplemental budget includes an additional \$20.8 million in special funds for continued requirements in operations and \$12.7 million in revenue bonds for the completion of several current projects on Oahu, Maui and Hawaii.

### Other Programs

Besides the immediate and critical needs discussed above, the Executive Supplemental Budget proposes a limited increase in operating funds to address other important areas such as public safety, disaster and emergency preparedness, energy efficiency improvements, continued support for renewable energy sources and an innovative economy, and greater conservation of Hawaii's natural resources.

Major CIP proposals also include Phase 1 of a new Public Safety Complex on Maui (\$50 million), repairs at Aloha Stadium (\$25.9 million), renovations at Washington Place (\$4.9 million), repairs of the State Capitol reflecting pool (\$7.9 million), energy conservation in public buildings (\$10.5 million), and improvements to small boat harbor facilities (\$10 million) and State parks (\$5 million).

### Unfunded FY 09 Program Expenses

The General Appropriations Act and other acts of specific appropriation in 2007 authorized a number of programs and services in FY 08 but did not provide funding for their continuation in FY 09, such as in the case of collective bargaining costs for Emergency Medical Services contracts, disaster emergency preparedness and logistics staff, and drug nuisance abatement staff. Where the programs and services are deemed necessary and beneficial for public purposes, or required by law, their expenses in FY 09 have been included in the supplemental budget, resulting in a total of \$5 million of such requests.

## THE GENERAL FUND FINANCIAL PLAN

Next month my Administration will submit a package of legislative proposals for your consideration, including measures that will have a financial impact. These proposals have been carefully developed to bring about changes that will help position Hawaii to meet the challenges and capitalize on the opportunities that will arise during the next decade.

The General Fund balance is projected to be \$475.4 million on June 30, 2008. Taking into account the requests contained in this Executive Supplemental Budget and the fiscal impact of legislative proposals to be submitted, including emergency appropriations for FY 08, the ending balance in the General Fund for the current fiscal biennium is projected to be \$213 million on June 30, 2009. The Six-Year General Fund Financial Plan shows a positive balance for each year in the 2007-2013 period.

Outside of the General Fund, the State maintains additional reserves in the Emergency and Budget Stabilization Fund. The balance in this rainy day fund is estimated to be \$62 million at the end of the fiscal biennium on June 30, 2009.

The State also holds a significant level of reserves in the Hawaii Hurricane Relief Fund. The balance in this fund is projected to be \$181.7 million on June 30, 2009.

It is important to note that the State's disciplined approach to managing its budget has been favorably recognized by all three major credit rating agencies. In the most recent G.O. bond sale in March 2007, the State of Hawaii maintained a rating of Aa2 with a stable outlook from Moody's Investors Services and an AA from Fitch Ratings. Standard & Poor's Ratings Services upgraded Hawaii from the AA- level to a solid AA. All three agencies credited the State's strong financial management for the high ratings received.

I respectfully ask for your favorable consideration of these recommendations and I look forward to working with you in the upcoming session to create a budget that is both fiscally prudent and responsive to the substantial needs of our community.

Sincerely,



LINDA LINGLE  
Governor of Hawaii

## APPENDIX TO THE GOVERNOR'S MESSAGE

### A. THE EXECUTIVE SUPPLEMENTAL BUDGET RECOMMENDATIONS

#### THE OPERATING BUDGET

##### All Means of Financing

For **FY 2008**, adjustments to the budget will be proposed through emergency appropriation measures to address shortfalls in the following areas:

- Adult Mental Health program (\$10 million in general funds)
- Emergency Medical Services (\$2 million in general funds)
- Increase in electricity costs (\$1 million in general funds)
- Highways program (\$20 million in special funds)

For **FY 2009**, total proposed adjustments to the operating budget amount to a net increase of \$306.7 million, or 2.9%, from all means of financing, as shown below.

Means of Financing	FY 09 Act 213/2007 Appropriation (\$)	FY 09 Proposed Adjustment (\$)	FY 09 Recommended Appropriation (\$)
General Funds	5,273,531,614	100,220,903	5,373,752,517
Special Funds	2,051,349,641	59,003,322	2,110,352,963
Federal Funds	1,699,966,165	14,778,442	1,714,744,607
Private Contributions	150,969	.....	150,969
County Funds	674,179	.....	674,179
Trust Funds	58,498,819	32,836,065	91,334,884
Interdept. Transfers	1,071,890,536	94,409,987	1,166,300,523
Revolving Funds	371,815,328	2,684,782	374,500,110
Other Funds	11,693,196	2,750,000	14,443,196
<b>Total</b>	<b>10,539,570,447</b>	<b>306,683,501</b>	<b>10,846,253,948</b>

The distribution by department and the Highlights of the Operating Supplemental Budget by department are presented in the sections that follow.

##### General Fund

For **FY 2009**, total proposed general fund adjustments to the operating budget amount to a net increase of \$100.2 million, or 1.9%, over the current appropriation level. The distribution by department is presented in the sections that follow.

It should be noted that two-thirds of the request (\$66.1 million) is due to the increase in fringe benefits costs, including pension accumulation and contribution for Social Security and Medicare, as mandated by Acts 213 and 256, SLH 2007.

##### Increase in Positions

The Supplemental Budget includes an increase in the number of permanent positions and a net decrease in temporary positions.

	<u>Temporary</u>	<u>Permanent</u>
Total adjustments	(158)	437
By means of financing:		
General Funds	(49)	301
Special Funds	(6)	39
Federal Funds	(61)	52
Trust Funds	(33)	1
Revolving Funds	(1)	14
Interdepartmental Transfers	8	14
Other Funds	(16)	16

The additional positions are for the following purposes:

- Establishment of 108 positions in the Department of Education (DOE) for autism services. The positions include teachers, educational aides, social workers and behavioral specialists. Providing services with DOE employees instead of contracted personnel is expected to result in cost savings and more continuity in the program.
- Addition of 56 positions in the Department of Public Safety, to include: 21 positions for compliance with the audit on the Mental Health Services program, 5 additional staff for the Inmate Classification Office to address overcrowding, 12 deputy sheriffs for neighbor island airports, 12 ACOs at correctional facilities on Hawaii, and 6 other positions.
- Addition of 41 positions in the University of Hawaii System to strengthen security measures on all campuses.
- Conversion of 12 positions in the Department of Transportation Harbors Division from the CIP to the operating budget.
- Addition of 15 positions in the Department of Land and Natural Resources for the Division of Conservation and Resource Enforcement.
- Conversion of a large number of temporary positions to permanent status to reflect the ongoing needs of various programs in the Departments of the Attorney General, Budget and Finance, Health, and Human Services.

#### THE CAPITAL IMPROVEMENT (CIP) BUDGET

For **FY 2009**, total proposed CIP adjustments amount to \$1.1 billion, to be funded from the following sources:

Means of Financing	FY 09 Act 213/2007 Appropriation (\$)	FY 09 Proposed Adjustment (\$)	FY 09 Recommended Appropriation (\$)
General Funds	.....	.....	.....
Special Funds	106,233,000	- 4,628,000	101,605,000
G.O. Bonds	131,261,000	560,924,000	692,185,000
G.O. Reimbursable	1,000,000	.....	1,000,000
Revenue Bonds	63,421,000	500,813,000	564,234,000
Federal Funds	164,713,000	20,685,000	185,398,000
Private Contributions	.....	.....	.....
County Funds	.....	.....	.....
Interdept. Transfers	11,500,000	.....	11,500,000
Revolving Funds	.....	.....	.....
Other Funds	<u>100,000</u>	<u>.....</u>	<u>100,000</u>
Total	478,228,000	1,077,794,000	1,556,022,000

The distribution by department and the Highlights of the CIP program by department are presented in the sections that follow.

The CIP requests reflect the continued commitment of the State to improving its infrastructure and capital assets to support the economic base and maintain the health, safety, and quality of life in Hawaii.

#### **B. THE MANDATORY TAX REFUND**

Section 6 of Article VII of the Hawaii State Constitution provides for a mandatory tax refund or tax credit if the general fund balance exceeds 5% of general fund revenues at the end of two succeeding fiscal years. For FYs 06 and FY 07, the ratios were 14.9% and 9.6%, respectively, and thus met the constitutional criteria. The Legislature will need to consider the enactment of legislation in this 2008 Session to comply with the mandatory tax refund as stipulated by the State Constitution.



### **C. THE GENERAL FUND EXPENDITURE CEILING**

By law, general fund appropriations must comply with the expenditure ceiling requirements that are set forth in Section 9 of Article VII of the State Constitution and Section 37-92 of the Hawaii Revised Statutes.

At the aggregate level that includes all branches of government, total proposed appropriations from the General Fund are within the expenditure ceilings for both FY 08 and FY 09.

For the Executive Branch, total proposed appropriations from the General Fund (which include the Executive Supplemental Budget for FB 2007-09 and other specific appropriation measures to be submitted by the Administration) are also within the appropriation ceilings for the Executive Branch in both FY 08 and FY 09.

A summary statement on the General Fund expenditure ceiling and Executive Branch appropriation ceiling is presented in the sections that follow.

### **D. THE DEBT LIMIT**

Section 13 of Article VII of the State Constitution places a debt limit on G.O. bonds that may be issued by the State. It has been determined that the total amount of principal and interest calculated on: a) all bonds issued and outstanding, b) all bonds authorized and unissued, and c) all bonds proposed in the Supplemental Budget (including State guaranties) will not cause the debt limit to be exceeded at the time of each bond issuance.

The Declaration of Findings with respect to the G.O. bond debt limit is presented in the sections that follow.

